

## BOOK REVIEW

*Jonathan R. Macey\**

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### Pop-Thinking About Japan

**Yen! Japan's New Financial Empire and its Threat to America.** Daniel Burstein. New York: Simon & Schuster, 1988. 335 pages. Cloth, \$19.95.

Daniel Burstein's flamboyant new book, *Yen*,<sup>1</sup> makes two fundamental errors typical of the pop-thinking about Japan that characterizes much recent journalism on the subject. First, Burstein compares Japan's economic performance to that of the United States and concludes that Japan's success somehow represents a dire threat to America. He could not be more wrong.

Burstein then describes important aspects of Japanese culture, particularly as that culture is reflected in Japanese management techniques, and concludes that all the U.S. must do to regain its competitive position *vis-a-vis* Japan is to copy the Japanese. In offering this unoriginal solution to what Burstein describes as the Japanese "threat," Burstein manages to demonstrate that his understanding of America is even more impoverished than his understanding of Japan.

Lurking just below the surface of Burstein's story about Japan is an undefended abhorrence of the Reagan administration and its free market economic philosophy. Burstein attempts to depict Japan as a twentieth century example of a successful centrally planned economy, and America as the paradigmatic example of the decadent horrors of unconstrained capitalism. Were it not for the fact that Burstein's crude generalizations were so broadly shared, it would be tempting to ignore his unsubstantiated monologue. Nevertheless, recent incidences of Japan-bashing by Americans, particularly in the 1988 presidential campaign, and the growing belief that Japan somehow is to blame for America's trade deficit, suggest that Burstein's unfortunate perspective cannot simply be ignored.

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1. D. BURSTEIN, *YEN! JAPAN'S NEW FINANCIAL EMPIRE AND ITS THREAT TO AMERICA* (1988).

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Throughout his book, Burstein makes it clear that he does not think himself an unsophisticated xenophobe or a racist. Indeed, he goes to some lengths to suggest admiration, if not fondness, for the Japanese people. Despite an occasional generous remark, however, the picture of Japan that emerges is that of a monolithic economic monster, populated by nationalistic automatons, whose every move is aimed at driving America to its knees and achieving world domination of the financial markets. By contrast, the U.S. is portrayed as a slovenly giant, paralyzed by short-sightedness, unproductivity and a chronic lack of leadership. Fortunately, the reality is far more complicated than Mr. Burstein would have us believe.

### I. The Japanese Economic Miracle as a Threat to U.S. Interests

It is very easy to make the case that Japan is financially successful at the moment. It is far more difficult to understand why their success should not be applauded. Put another way, Burstein shifts from a thumbnail description of Japan's success to the conclusion that the Japanese are to blame for the economic problems that now confront the United States. This crucial move is performed by Mr. Burstein with all the dexterity of a ten year-old amateur magician. Indeed, at the heart of Mr. Burstein's book is a thinly veiled warning that Japan will convert its economic assets into military assets, and pose a real strategic threat to the United States.<sup>2</sup>

#### A. Japan's Success

After World War II Japan's economy lay in ruins. By 1950, its per capita income was less than three-fourths of the pre-war level.<sup>3</sup> Japan steadily improved its position, however, and by 1963 was firmly ensconced among the world's industrialized countries.<sup>4</sup> In terms of the all-important indicia of per capita income, measured in terms of purchasing power parities, Japan has achieved remarkable success. By 1987 its purchasing power, measured on a per capita basis, was about 91 percent of the United States's. This places Japan well ahead of Italy and the United Kingdom, slightly ahead of France, and just below West Germany.<sup>5</sup>

Thus, on its face, Japan appears simply to have regained its pre-war stature as an industrial giant. There is no particular reason to believe that Japan will come to dominate the world scene. The source of alarm appears to be the fact that Japan's GNP has been expanding at about twice the rate of the U.S. Extrapolating from these rates of growth, Herman Kahn predicts that the Japanese economy will become as large as

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2. See, e.g., *id.* at 19, 27, 71, 271, 272, 280-81, 284-92.

3. B. BALASSA & M. NOLAND, JAPAN IN THE WORLD ECONOMY 3 (1988).

4. *Id.*

5. *Id.*

the U.S. economy by the year 2000.<sup>6</sup>

Before reaching any conclusions about Japan's economic future, however, one must have a theory about how Japan has been able to attain its present level of success in the wake of the massive destruction of the Second World War. By better understanding Japan's success, we will be able to assess its prospects for the future.

By far, the best explanation for Japan's economic miracle has been advanced by Mancur Olson, who, in his path breaking book, *The Rise and Decline of Nations*,<sup>7</sup> observed that the powerful distributional coalitions that existed before the war were destroyed during the Allied occupation. With the destruction of these distributional coalitions came rapid economic growth.

Distributional coalitions (also known as interest groups) slow economic growth for three reasons. First, they devote resources to redistributing wealth to themselves from society as a whole. These efforts at wealth redistribution consume real resources, force other people to waste resources in order to block such wealth transfers, and provide severe disincentives to investment because potential investors must worry that some distributional coalition will expropriate any investments they make. Import tariffs, taxes aimed at wealth redistribution and regulation of the contracting process are all mechanisms by which distributional coalitions can transfer wealth to themselves from society at large.<sup>8</sup> Second, the proliferation of distributional coalitions staggers the rate of economic growth by slowing down society's capacity to adopt new technologies and to reallocate resources in response to changing conditions.<sup>9</sup> Third, the growth of distributional coalitions increases the complexity of regulation, the role of government and the complexity of understandings, thereby making society less productive, particularly in the long run.<sup>10</sup>

After the war, Japan was temporarily freed from the shackles of these pernicious distributional coalitions, and the economic energy of the nation was unleashed. Yet, as time goes on, and Japan's distributional coalitions regain strength, it seems inevitable that its growth rates will slow as economic energy is diverted from wealth creation towards wealth transfer.<sup>11</sup>

One thing appears certain—Japan's success cannot be attributed to vague cultural differences between Japan and the United States that cause the Japanese to work harder. As Olson has observed, while many people attribute the success of the Japanese to the characteristics of the Japanese culture or its people, until the mid-nineteenth century, Japan

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6. H. KAHN, *THE EMERGING JAPANESE SUPERSTATE: CHALLENGE AND RESPONSE* (1970).

7. M. OLSON, *THE RISE AND DECLINE OF NATIONS* (1982).

8. *Id.* at 42-46.

9. *Id.* at 74.

10. *Id.* at 73.

11. *Id.* at 76.

did not distinguish itself as an economic powerhouse. Indeed, "the conventional wisdom among Western observers was far different than it is today, with some alleging that Japanese character or culture was intrinsically incapable of economic development."<sup>12</sup>

The social and political upheaval that led to the Meiji restoration abolished many of the trade restrictions that had hampered Japan's economic growth. As the Meiji government eliminated the barriers to a national market, Western powers, particularly Britain, restricted the ability of the Japanese to impose tariffs on imports.<sup>13</sup> The abolition of these restrictions led to the unprecedented economic growth in Japan of the 1880s and 1890s.

#### B. Japan's Success as a Threat to the United States

Perhaps the most perplexing aspect of Mr. Burstein's approach to the Japanese phenomenon is its failure to articulate why Japan's success poses such a threat to the United States. At times, Burstein suggests that every dollar gained by a Japanese means a dollar lost by an American. In particular, when Burstein describes the recent success of Japanese financial intermediaries such as Sumitomo Bank or Nomura Securities, he implies that the growth of these firms has meant not only the "enrichment of Japan" but also "the erosion of American economic strength."<sup>14</sup>

Nevertheless, there is no reason to believe that Japanese economic success comes at the expense of American wealth. Indeed, the better argument appears to be that the opposite is true. As Japanese firms produce better products at lower prices, American consumers benefit. American firms and American workers compete with the Japanese, just as they compete with one another. Contrary to Burstein's assertions, however, the game is not zero sum. The competitive process leads to innovation, to lower production costs and, ultimately, to an increase in wealth.

Burstein implies, for example, that the U.S. suffered as a result of the stiff competition in the automobile industry in the 1970s. Burstein describes the scenario as one in which jobs were lost, profits were narrowed and opportunities for growth lost.<sup>15</sup> Nothing could be further from the truth. Consumers clearly profited from the global rivalry, and ultimately, American automobile companies were forced to produce far better products at lower prices due to the healthy influence of Japanese competition. Thus, competition from Japanese producers should be viewed as a healthy, albeit painful, aspect of modern life. The global economic competition of the 1980s is not a zero sum game. These competitive pressures lower prices, improve the quality of productive output and ultimately enrich the lives of American consumers.

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12. *Id.* at 151.

13. *Id.* at 152-53.

14. D. BURSTEIN, *supra* note 1, at 258.

15. *Id.*

The analogy that Burstein seeks to draw between Japanese competition in the automotive industry and Japanese competition in the financial services sector is appropriate in only one respect. In the United States, both the automotive industry and the financial services industry have been characterized by high barriers to entry, stodgy management techniques and poor product performance. By contrast, their Japanese rivals faced stiff domestic competition before venturing out into the global markets. It was, therefore, unsurprising that the Japanese met with early success. Eventually, however, American automotive firms, particularly Ford, began to compete more effectively with the Japanese. All consumers, but particularly American consumers, benefitted by this competition.

It is worth emphasizing that in areas such as home appliances and computer software, where U.S. firms have faced stiff domestic competition for a number of years prior to entry by the Japanese, the Japanese did not come to dominate international competition. Indeed, a clear pattern emerges. The Japanese consistently have been able to locate areas of economic activity in which high concentration ratios have led to high profit margins. Mr. Burstein's depiction of the Eurobond market fits this model perfectly.<sup>16</sup> In order to succeed in this market, firms must have a lot of reputational capital because international credibility is important to market participants. This need for reputational capital allowed a small number of western firms to dominate the market and garner sizeable returns at low risk. Beginning in the mid-1980s, however, the large Japanese investment banks, particularly Nomura, Daiwa, Yamaichi, Nikko, and the Industrial Bank of Japan, entered the market and eventually came to dominate it. They did this by cutting spreads. As Burstein concedes, "[t]raditionally high margins have become wafer thin."<sup>17</sup>

Burstein's view that these events harm U.S. interests is patently incorrect. Now, when U.S. firms go to the Eurobond market to raise funds, they can do so at lower rates of interest. The new, lower rates enable these firms to fund more activities more cheaply. The result is higher employment and lower product prices, as firms' cost of capital declines. Thus, the intense competition that came with the arrival of the Japanese to the Eurobond market directly benefits U.S. interests. It was the old, quasi-cartelized system that harmed U.S. interests.

Thus, Burstein's argument that Japan's economic success comes at the expense of America's economic interests is simply wrong because it is based on the erroneous premise that economic success is a zero sum game. The success of Japanese firms in global competition benefits American consumers by providing consumers with better quality products at lower prices. The same is true of Japan's success in the world capital markets. Increased competition in the supply of capital will

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16. *Id.* at 241.

17. *Id.*

lower the cost of capital and result in lower interest rates. Lower interest rates bring significant economic benefits such as higher wage levels and lower housing costs.

Burstein also suggests that Americans will be harmed if the Japanese become so successful that the U.S. is displaced as the economic capital of the free world. It is unclear why this should be the case. Perhaps we derive some sort of "psychic income" from being the most important player in world financial affairs. The U.S., however, has only itself to blame for losing its place as the major player in the world financial markets. Our financial system is hampered by a panoply of populist-based laws and regulations that impede the growth of our financial services firms. These laws include the Glass-Steagall Act, which prohibits the same firm from performing both commercial and investment banking services; the Bank Holding Company Act, which bars most corporations from owning banks; the Change in Bank Control Act and the Bank Merger Act, which impede the market for corporate control of banks; and the Douglas Amendment to the McFadden Act, which impedes interstate banking. These restrictions prevent U.S. financial services firms from achieving the size and scope of Japanese firms.

As even Burstein recognizes, by the year 2000 the world "will be dominated by a small group of mega-financial institutions."<sup>18</sup> None of these mega-financial institutions is American. All ten of the world's largest banks in terms of deposits are Japanese, and the largest Japanese securities firm, Nomura, is larger than the top twenty American securities firms combined. It is twenty times the size of the largest U.S. securities firm, Merrill Lynch. The point should be obvious: it is not the Japanese who are somehow depriving U.S. investment banks of a dominant position in the world of finance, but rather, it is U.S. laws that prevent the financial services industry from attaining a sufficient capital base to compete effectively in global markets.

In fact, the U.S. should welcome the entry of Japanese competitors into global capital markets. As information technologies develop, it is inevitable and desirable that individual nations will sacrifice their ability to single-handedly influence world affairs. This decline in the ability of sovereign powers to influence events will lead to greatly enhanced individual freedom and human rights. It will also signal the emergence of a single, globalized financial marketplace.

It is unlikely that a single country, be it the United States or Japan, will dominate this market in the long run. Furthermore, as the world becomes more interdependent, we appear to be witnessing the decoupling of economic power and military power. Japan is the first non-military superpower. After 1992 Europe will probably emerge as the second. The U.S. and the Soviet Union will be important participants in world markets only to the extent that they can offer quality products at competitive prices.

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18. *Id.* at 237.

Perhaps the most revolting, and certainly the most erroneous, of Burstein's reasons for bemoaning Japanese domination of the securities markets is contained in a portion of the book subtitled "Money Without Morals."<sup>19</sup> In this chapter, Burstein manages to infer that the Japanese are less moral in their business dealings than are Americans. The fact is that foreign aid by all countries, particularly the United States, is done at least in part to further national goals. Much of the foreign aid expenditures of the United States are justified on the basis of furthering the nation's long-term strategic interests. Aid to Latin America and Israel, which comprises the bulk of U.S. foreign aid expenditures, is justified explicitly in these terms. For Burstein to single out Japan and attempt to distinguish it from the U.S. by underscoring Japanese efforts to further its own interests through foreign aid policies is simply outrageous. It is also misleading. Japan spends a larger portion of its GNP on foreign aid than does the U.S., and according to James Fallows, is about to surpass the U.S. in total foreign aid.<sup>20</sup>

Moreover, to claim, as Burstein does, that the Japanese lack the "impulse to global charity"<sup>21</sup> is simply erroneous. In fact, Japan has a well deserved reputation for generosity in foreign aid, particularly among other Asian countries. Burstein, however, even manages to fault Japan for concentrating its charitable giving among its neighbors.<sup>22</sup> More recently, however, at the five power economic summit in Toronto in the summer of 1988, Japan proposed a bold and generous new Latin American debt plan, sending a clear signal that the Japanese recognize their global responsibilities and are prepared to fulfill them.

## II. What Lessons Should Americans Learn from the Japanese?

Burstein warns that unless America changes:

Like postwar Europeans, twenty-first century Americans will have to come to grips with a world that is no longer theirs—a world in which U.S. currency, institutions, corporations, and culture are no longer *de facto* international standards. True, the U.S. economy is inherently too diverse, its market too large, and its military superiority too far ahead for American power to evaporate as rapidly as Britain's did after World War II. But at least Britain had the luxury of declining into an American-dominated order with which it shared both a cultural affinity and a special political relationship. In the twenty-first century, the United States faces the possibility of declining into a fiercely competitive and potentially hostile Japanese- and Pacific-influenced world order.<sup>23</sup>

Yet the changes Burstein has in mind would make America's position in the world economic order even more precarious. Burstein does not appear to have learned the lesson that virtually every world leader from

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19. *Id.* at 250.

20. Fallows, *Containing Japan*, THE ATLANTIC, May 1989, at 40, 46.

21. D. BURSTEIN, *supra* note 1, at 251.

22. *Id.*

23. *Id.* at 294.

Mikhail Gorbachev to Margaret Thatcher has found so fundamental: market forces are superior to central planning as a means for allocating societal resources. Thus, Burstein rejects the most fundamental lesson of the post-war period. In place of an economic system in which market forces allocate societal resources, Burstein advocates a quasi-socialist system in which we achieve a Japanese-style consensus about resource allocation.

Burstein says that the American consensus "must" reflect "some general level of agreement about what constitutes the public interest and the public good."<sup>24</sup> He goes on to bemoan the "shift toward personal wealth as the chief motivating factor in American life," calling it "antithetical to national prosperity as a whole."<sup>25</sup> In place of the profit motive, Burstein would substitute the tired old socialist idea that resources should be allocated on the basis of an as-yet-undefined "industrial policy" dictated by an unnamed leadership, presumably acting on the basis of "national consensus."<sup>26</sup> Burstein, of course, cannot define the "public interest." Therefore, he cannot tell us anything about what this national consensus would look like.

There are three flaws with Burstein's approach to America's economic crisis. First, as the world becomes more competitive, placing confidence in the ability of a single country to respond to rapidly changing economic conditions on the basis of central planning is simply farcical. Central planning has never been an effective mechanism for allocating resources, and its appeal becomes weaker as the world becomes more complex. Central planners are simply unable to obtain and assimilate information as effectively as the price mechanism of the marketplace. Thus, Burstein's suggestion that the U.S. replace its present commitment to market ordering with a new reliance on the central planning required by industrial policy is a recipe for disaster.

Second, Burstein argues that the American entrepreneurial spirit was an innovation of the Reagan years and had not been a part of the American scene before the 1980s. In making this assertion, Burstein manages to ignore two hundred years of American history. Indeed, until Franklin Roosevelt's New Deal, a *laissez faire* economic philosophy which manifested itself in the form of substantive due process, had, for better or for worse, been considered an implicit component of American constitutional law. In fact, entrepreneurialism is an important part of American culture. Central planning has long met with suspicion. Burstein is simply wrong to blame America's current woes on a policy of *laissez-faire*.

Third, in a nation as diverse and heterogeneous as the U.S., individual initiative has been given a high premium because the diversity that characterizes this country makes consensus unlikely except in times of

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24. *Id.* at 296.

25. *Id.* at 297.

26. *Id.*



grave national crises. Thus, while the Japanese succeed by working from consensus, Americans' greatest successes will continue to be made by mavericks, who, striking out on their own in pursuit of profit, have enriched themselves, and mankind as well. The notion that you can simply transport a cultural system that builds upon consensus to a country as ethnically and culturally diverse as the U.S. is ludicrous. Similarly, Burstein's admonition that "our values must undergo change"<sup>27</sup> cannot be achieved so long as we remain a strongly pluralistic nation.

In other words, the U.S. has no choice but to work from its natural endowment, which includes an ethnically and culturally diverse population with a high proportion of individualists. Japan is not a diverse nation. Consequently, Japan has a far greater ability to work from consensus, but does not share the United States's capacity to benefit from the contributions of rugged individualists.

Burstein argues that "election-year cycles, partisan politics, and combative, contradictory special-interest groups must be held in abeyance."<sup>28</sup> Burstein is, of course, correct in assuming that special interest groups have been harmful to the economic well-being of the United States. Nevertheless, he ignores two important facts. First, he ignores that the special interest group problem is not unique to the United States. In recent times Japan, with its powerful agricultural interests, construction industry coalitions and other interest groups, has suffered from the problem of factions just as much as the United States. Domestic problems in Japan such as high food and housing costs are, at least in part, attributable to interest group wealth transfer activity. Japan had a short-run advantage over the U.S. because the instability of the post-war period destroyed many special interest groups in Japan and reduced the power of others. The U.S., however, probably has a long run advantage over the Japanese in dealing with the interest group problem because, unlike Japan, the U.S. Constitution is designed specifically to mitigate the efficacy of such groups.<sup>29</sup> Such interest group-based problems as election finance and corruption of elected officials are an even larger problem in Japan than in the United States.

Another mistake Burstein makes regarding the problem of interest groups is his failure to recognize that his plan to replace free trade policies with industrial policy will inevitably lead to more, rather than less, partisan politics. Indeed, a shift to a widespread industrial policy will open the door to a whole new era of interest group domination of the political process. Industrial policy will be used to provide the public interest patina on a whole panoply of interest group-oriented wealth transfers. For example, import quotas have been justified on the ground that they allow infant industries to obtain stability before being buffeted by the rigors of international competition. The post-war Japanese expe-

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27. *Id.*

28. *Id.* at 296.

29. See generally Macey, *Transaction Costs and the Normative Elements of the Public Choice Model: An Application to Constitutional Theory*, 74 VA. L. REV. 471 (1988).

rience, however, shows that industries protected from competitive pressure do worse, not better, in the international arena than industries that face such competition. Similarly, politically powerful industries attempt to justify wealth transfers to themselves from other sectors of the economy on the specious grounds that somehow the industrial policy of the United States should favor such industries. In the absence of market forces to guide the allocation of capital, however, the quest for funding becomes purely political. Interest groups are bound to become dominant players in such a scenario.

Thus, allocating resources according to a national industrial policy instead of according to supply and demand conditions dictated by the market will dramatically raise the payoffs available to interest groups who engage in wealth transfer activity. These new, higher stakes will provide greater incentives for interest groups to engage in partisan political struggle for wealth transfers.

### Conclusion

Japan's post-war emergence as an economic superpower should be viewed as entirely beneficial to the United States from virtually every perspective. Japan's productivity has been unambiguously beneficial to the American consumer. Not only have Americans been able to purchase a variety of well-made products at competitive prices, but Japanese competition eventually forced the stodgy American steel and automotive industries to become competitive. In other words, Japanese competition forced American industry to awaken to the fact that global competition is inevitable.

Even if the Japanese had never become an economic superpower, the U.S. would face stiff international competition from a newly united Europe in 1992, from increasingly sophisticated Korean producers and ultimately from Eastern bloc countries that are gradually being freed from the shackles of central planning. Thus, the Japanese are only the first in what probably will be a continuous wave of important new competitors on the world economic scene.

In this new multi-polar economic environment, both Japan and the United States will play important roles. It is highly unlikely, however, that any nation will completely dominate the world scene as the U.S. did immediately after World War II. Most important, we must recognize that the Japanese have attained their success within the constraints imposed by economic reality. They are a very homogeneous people who live on crowded islands. Americans are an extremely diverse people spread out on a relatively large land mass. These constraints will shape the way that Americans and Japanese respond to the competitive pressures of the future. The only real threat to the continued friendship and cooperation of the two countries comes from people like Daniel Burstein who advocate making America "competitive" by choking off world markets, and by imposing central planning on American indus-

tries. These policies would harm domestic consumers and undermine the stability of the world economic order. In other words, the danger to America from Japan's post-war success is that it provokes pop thinkers like Daniel Burstein to propose such dangerous "remedies."



# BOOK REVIEW

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**Trading Places: How We Allowed Japan to Take the Lead.** Clyde V. Prestowitz. New York: Basic Books. 365 pages.

Early on in his book, *Trading Places: How We Allowed Japan to Take the Lead*,<sup>1</sup> Clyde Prestowitz refers to the offer made by Fujitsu Corporation (Japan's leading computer manufacturer) on October 24, 1986, to buy the Fairchild Semiconductor Company.<sup>2</sup> Fujitsu withdrew its offer after both Secretary of Commerce Baldrige and Secretary of Defense Weinberger opposed it "on the grounds that the United States was becoming too dependent on Japan for critical technology." Commenting on the event, Prestowitz observes:

In 1981, the secretaries of commerce and defense would not have noticed—let alone objected to—Fujitsu's bid for Fairchild. Now they did. In 1981, the United States, although less dominant than previously, was still the world leader in industry, technology and finance as well as in military power. In 1987, it was the leader only in military power, and even there was facing the necessity of reducing commitments. In other areas, the United States, which had played the role first of occupier and then of protector and mentor, had traded places with its former protégé—Japan.<sup>3</sup>

Thus he sets the stage for his skillful analysis of how the Japanese have done what they've done and how, wittingly and unwittingly, we have helped them.

Prestowitz is particularly well qualified to address the issues involved. Since 1964, when he first spent time in Japan as a graduate student, his considerable skills and intellect have focused on that country's development, as a businessman living in Japan and competing for market share, as Counselor for Japan Affairs to the U.S. Secretary of Commerce from 1981 to 1986, and now as Senior Associate at the Carnegie Endowment in Washington, D.C. He observes in the introduction to the book that "today, a little over forty years after the end of the Second World War, Japan and the United States are again being drawn into increasingly rancorous confrontations reminiscent of the past, stemming from the same misunderstandings, and carrying some of the

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1. C. PRESTOWITZ, *TRADING PLACES: HOW WE ALLOWED JAPAN TO TAKE THE LEAD* (1988).

2. *Id.* at 5.

3. *Id.* at 7.

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same dangers.”<sup>4</sup> His self-expressed purpose in writing the book is to “make some small contribution to a better understanding and to avoiding further friction between the two countries.”<sup>5</sup> Whether the book succeeds in its larger purpose of avoiding friction remains to be seen and will depend on how many leaders in policy-making positions on both sides of the Pacific heed its lessons. In its lesser purpose of increasing understanding, the book succeeds admirably.

Characterizing the U.S. businessman of the past forty years as “the cowboy of the world marketplace,” and the Japanese as “more like our early settlers,”<sup>6</sup> Prestowitz argues that “the crux of the situation is that the United States and Japan have fundamentally different understandings of the purposes and workings of a national economy.”<sup>7</sup> The problem is not essentially one of poor American management or laziness;<sup>8</sup> rather, it is the failure to recognize that “management, good or bad, is not an isolated phenomenon but operates in the context of a particular nation.”<sup>9</sup> If only we had a better understanding of these fundamental differences in outlook,<sup>10</sup> Prestowitz suggests, we would be able to see more easily why “few, if any, American companies can compete with the Japanese in the areas the latter deem important.”<sup>11</sup>

Prestowitz describes precisely how this has already happened across

4. *Id.* at xiv.

5. *Id.*

6. *Id.* at 14. Although Prestowitz skillfully uses this analogy throughout the book to illustrate contrasting approaches between the two countries, he is not the first to adopt it. See, e.g., Sato, *Government-Business Relationships in the United States and Japan*, in STRATEGIC MANAGEMENT IN THE UNITED STATES AND JAPAN: A COMPARATIVE ANALYSIS 15 (R. Tung ed. 1986) [hereinafter STRATEGIC MANAGEMENT]:

Let me briefly compare our two nations: The United States is the ultimate frontier country. Of all the great nations, it is the one with the greatest margin of safety for experiment, whether for economic opportunity or for political self-government. Secure between two oceans, the United States is a vast land mass abundant in natural resources; however, it has always needed to import human resources. Now turn to Japan. It is a bleak offshore archipelago that, ever since it set out to be more than a subsistence economy, has had to devote much of its talents merely to buy the most basic raw materials from abroad.

7. C. PRESTOWITZ, *supra* note 1, at 13.

8. “[P]inning all the blame for poor U.S. performance on business management is simplistic at best and demagogic at worst.” *Id.* at 190. If Japanese management were so superior to American management, why would Japan’s bankruptcy rate be “twice as high as that in the United States?” See Pucik, *Management Practices and Business Strategy in Manufacturing Firms*, in STRATEGIC MANAGEMENT, *supra* note 6, at 116.

9. C. PRESTOWITZ, *supra* note 1, at 13.

10. The social and industrial structure of Japan has made it an extremely difficult market to penetrate; furthermore, the Japanese government views industrial performance as akin to national security and pours enormous energy into ensuring that its industry is the world leader. By comparison, the United States has been relatively easy to penetrate. Its open society makes for an open market that has welcomed foreign goods and foreign businessmen. Most important, however, the United States does not view industry as a matter of national security as Japan does.

*Id.* at 13.

11. *Id.*

a variety of industries;<sup>12</sup> and points to others in which the process could easily be repeated.<sup>13</sup> There may, however, be other explanations for the results in the case of particular products.<sup>14</sup> We might fault Prestowitz for emphasizing the damaging impact of Japanese practices on American competitors at the expense of downplaying the cost of those practices to the Japanese.<sup>15</sup> And there might be explanations for the behavior of American companies in particular instances beyond those Prestowitz provides.<sup>16</sup> Overall, however, the case Prestowitz makes for his position

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12. Prestowitz illustrates the phenomenon in greatest detail with an entire chapter, Chapter 2, devoted to describing how the U.S. semiconductor industry most recently lost its ability to compete with the Japanese in commercial markets. *Id.* at 26-70. He includes briefer descriptions of how the same thing had happened earlier in the case of televisions, *id.* at 200-06; VCRs, *id.* at 206; machine tools, *id.* at 218-29; and hydrogenerators, *id.* at 234.

13. *E.g.*, the aircraft industry, *id.* at 240-41.

14. Gary Saxonhouse argues, for example, that the decline in demand for the products of the American machine tool industry which occurred in the early 1980s "owes more to the sharp cyclical downturn of the American economy and the technological obsolescence of certain of its products than it does to import competition." Saxonhouse, *The National Security Clause of the Trade Expansion Act of 1962: Import Competition and the Machine Tool Industry*, in *LAW AND TRADE ISSUES OF THE JAPANESE ECONOMY: AMERICAN AND JAPANESE PERSPECTIVES* 234 (G. Saxonhouse & K. Yamamura eds. 1986) [hereinafter *LAW AND TRADE ISSUES*].

15. Kozo Yamamura and Jan Vandenberg point out that although Japan's policies promoting vigorous economic growth and export expansion in the television industry may have been extremely successful by all quantitative evidence, they were "far from cost free." They assert that "at least in the case of the consumer electronics industry, the costs imposed on Japanese consumers were higher, perhaps substantially higher, than those justified in the name of achieving rapid economic growth." Yamamura & Vandenberg, *Japan's Rapid-Growth Policy on Trial: The Television Case*, in *LAW AND TRADE ISSUES*, *supra* note 14, at 268.

16. In the case of aircraft, for example, Prestowitz characterizes Boeing's decision to engage in a joint venture with several Japanese companies for development of the next generation airliner as an undesirable alternative to Boeing's developing the plane itself but perhaps the only viable response to Europe's subsidization of the airbus. C. PRESTOWITZ, *supra* note 1, at 240. He portrays the situation as "the ultimate irony of the Japanese government subsidizing an American industry upon which our own government has turned its back." *Id.* A Boeing representative, however, has explained in some detail how the elements of Japan's targeted industry approach do not really pertain in the case of commercial aircraft:

A first requirement is a large domestic market. In Japan's case, the domestic market for commercial aircraft is very small. They represent about 5 percent of the world market, and that is not big enough to support a large production volume. Consequently, they cannot first build an industry through a protected home market. A second requirement is the potential for large-volume production. . . . [T]he aircraft industry is typified by low-volume production. A third requirement is significant potential for innovations to the production process. The potential for this in the aircraft industry is somewhat limited due to restricted volume and the cyclical nature of the industry. A fourth requirement is orientation toward technology exploitation rather than technology development. The Japanese fare reasonably well on this criterion since they are oriented toward both. A fifth requirement is limited market risk and low volatility. This requirement is not met, as discussed earlier. A sixth requirement is employment stability. The lifetime employment practice of Japan does not fit the large swings in employment characteristic of the industry. A seventh requirement is a related military base. This is important

is convincing.

Is the case hopeless then? No, not if we educate ourselves to the structures the Japanese have put in place to achieve the stunning results of the past couple decades so that we can better deal with them. Part II of the book is a useful effort in providing us with that information. Entitled "What Makes Japan Run," it includes discussion of the Japanese sense of difference and the perception gap that it creates for our relationship,<sup>17</sup> the structure and nature of the Japanese bureaucracy,<sup>18</sup> the tools of Japan's industrial policy,<sup>19</sup> and a general description of Japanese business practices.<sup>20</sup> While other sources, scholarly and popular, have already appeared covering each of these areas in greater detail,<sup>21</sup> and while some of the specific points he makes may be open to debate,<sup>22</sup> Prestowitz gives us considerable value based on the experiences he had and the insights he developed as a U.S. policy-maker during the period

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in Japan; hence there is a good/fair fit here. An eighth requirement is adequate resources for multiproduct capability. At present Japan does not have the aerospace capability to produce a family of commercial aircraft models. The combined aerospace employment of the major Japanese aerospace firms that are potential producers of commercial aircraft is about one-tenth that of Boeing. Therefore, it will be some time before this criterion is satisfied.

The preceding rationale explains why we are willing to take the risk of collaborating with Japan—because commercial aircraft does not fit the pattern of their targeted industry approach. It is a very different type of business from those in Japan that achieved preeminence through the targeted industry approach.

Bacher, *Strategic Management in Manufacturing: The Case of Aircrafts*, in STRATEGIC MANAGEMENT, *supra* note 6, at 91, 94.

17. C. PRESTOWITZ, *supra* note 1, at 73-99 (ch. 3).

18. *Id.* at 100-21 (ch. 4).

19. *Id.* at 122-50 (ch. 5).

20. *Id.* at 151-84 (ch. 6).

21. Some of the more notable examples include J. ABEGGLEN & G. STALK, KAISHA: THE JAPANESE CORPORATION (1985) and C. JOHNSON, MITI AND THE JAPANESE MIRACLE (1982). A notable example of a book-length study of an industry covered by Prestowitz in lesser detail is D. OKIMOTO, COMPETITIVE EDGE: THE SEMICONDUCTOR INDUSTRY IN THE U.S. AND JAPAN (1984).

22. For example, Prestowitz emphasizes how the high level of company debt in Japan has lowered the cost of capital and enabled companies to leverage investment rates to potentially three times the rate of earnings growth. C. PRESTOWITZ, *supra* note 1, at 168-71. Experts generally agree on the existence of the phenomenon and its impact. See, e.g., Davidson, *A Comparative Analysis of Corporate Capital Structure in the United States and Japan*, in STRATEGIC MANAGEMENT, *supra* note 6, at 146:

Low-cost capital permits Japanese firms to pursue long term, capital intensive strategies not available to their U.S. counterparts. This factor, rooted in the Japanese capital markets, provides Japanese industry with its greatest competitive advantage.

However, emerging trends may change the picture. See Isoda, *Japanese Corporate Finance and Corporate Capital Structure*, in STRATEGIC MANAGEMENT, *supra* note 6, at 155, 165:

[S]ince the 1973-1974 oil crisis two major trends in Japanese financing emerged. One, the shift from bank borrowings to capital market financing, with a concomitant move from bonds issued with mortgages to unsecured bonds. Two, an emphasis on equity financing rather than debt. . . . In light of . . . changes in capital structure, it should not be long before nonoperating



he describes. Especially important are his analyses of bureaucratic power,<sup>23</sup> procedure as power,<sup>24</sup> promotion of new industries,<sup>25</sup> and restructuring of mature industries.<sup>26</sup>

Of course, studying what has created Japan's success is only half the story. We must also examine our own side of the formula. This Prestowitz does in Part III, captioned, "What Makes America Wind Down." He addresses the same problems we have all heard about so often lately: the flight of U.S. technology,<sup>27</sup> short-term profit prevailing over long-term growth,<sup>28</sup> declines in quality and productivity,<sup>29</sup> and the "isolation of U.S. business," *i.e.*, the lack of identity which Prestowitz sees our press, consumers and government as having with American business.<sup>30</sup> Again, what makes the discussion valuable is Prestowitz's past connection with both the companies and the government during the period under consideration. His intimate knowledge of the players

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or financial profit will play as important a role as operating profit in Japanese corporate financial management.

23. C. PRESTOWITZ, *supra* note 1, at 115-18.

Some U.S. observers of Japan attempt to downplay the power of today's bureaucrats. . . . Such arguments are misleading because of the tendency to equate diminution of power with loss of power. In particular, there is an obtuse tendency to interpret Japan in terms of the United States and to assume that if there is no overt legal basis for power, it does not exist. To accept this fallacy is vastly to overemphasize the actual loss of power and to ignore the subtle, nonlegalistic nature of Japanese society.

*Id.* at 115.

24. *Id.* at 118-21. The result of the system which has evolved is that "ministries write the laws, then write the interpretive ordinances, administer the laws, and handle most complaints arising from them." *Id.* at 119.

25. *Id.* at 130-38. Prestowitz's analysis of the many tools Japanese ministries have at their disposal at the policy-execution stage is particularly revealing when he demonstrates how they have been applied in the areas of optical fibers, supercomputers and aircraft.

26. *Id.* at 140-44.

The combination of Japan's industry promotion policies and the peculiar nature of its companies . . . tends ultimately to create the problem of excess production capacity, which in turn leads to what the Japanese call "excessive competition" involving severe price cutting and financial losses. . . . To restrain excessive competition, Japan has developed an elaborate set of tools, providing for the establishment of legal cartels under which companies may engage in such collaborative activity as joint restrictions on production and joint reductions in capacity. Administration of these measures involves extremely close cooperation between industry and government and gives officials even greater power than does industry promotion.

*Id.* at 140-41.

27. *Id.* at 206-08.

28. *Id.* at 208-11.

29. *Id.* at 211-13.

30. *Id.* at 213-16. Referring to the competition between American states to procure Japanese reverse investment, Prestowitz observes:

[I]n Japan MITI coordinates the policies of the various provinces to prevent them from bidding against one another for foreign investment. In the United States, it's everyone for himself. There seems to be no concept that we all might be better off if we supported each other. And so U.S. business feels isolated and vulnerable.

*Id.* at 214.

in U.S. trade negotiations<sup>31</sup> and the course of U.S.-Japan trade negotiations during 1981-1987<sup>32</sup> have led him to conclude that the United States confronts a serious conflict between its economic and its national security.<sup>33</sup>

Having laid out his views of why Japan has succeeded while American fortunes have declined, Prestowitz concludes with an assessment of the current situation and prescriptions for future action by both the United States<sup>34</sup> and Japan<sup>35</sup> in Part IV, "A Look to the Future." His recommendations are very much in line with those advanced in studies also published in 1988 by other leading think tanks and the Joint Economic Committee,<sup>36</sup> which are in turn compatible with arguments and proposals which some of our leading academics have made in recent years for adoption of a rational, competitive industrial policy by the United States.<sup>37</sup>

All of these studies, steeped in bureaucratic regulation theory and to a lesser extent market regulation theory, have recently been challenged to some extent by David Friedman, who asserts that mainstream scholarship has misunderstood the basis of the Japanese miracle; his study, based on the machine tool industry, argues that Japan's success is instead the result of the dramatic expansion of small manufacturers, constant product innovation (which Friedman claims is more important than efficiency gains), and the rapid, flexible responses of specialty firms to changing market opportunities.<sup>38</sup> In other words, he does not write off the cowboy to quite the extent Prestowitz seems to have done in his embrace of the settler. Perhaps there is room, and a need, for both.

Whatever the ultimate outcome of the contest between cowboy and settler, *Trading Places* also has a number of things to say to lawyers and their clients who deal with our system of trade law, to the bureaucracy which administers it, and to the combination of executive and legislative authority which generates it. To a lawyer, the book's contributions in

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31. *Id.* at 250-71 (ch. 9).

32. *Id.* at 272-302 (ch. 10).

33. Prestowitz uses the machine tool industry case to illustrate the impact of this conflict. *Id.* at 217-49 (ch. 8).

34. Cut the U.S. budget deficit and increase savings, stop blaming everything on the incompetence and greed of our business executives, and coordinate policies affecting industrial production in such a way as to recognize that micro—and macro—economic policies are inextricably intertwined. *Id.* at 314-29.

35. Carry out land reform, adopt pro-consumer policies, become an international market in regard to both trade and investment, and bear more of the cost of maintaining the free-world system. *Id.* at 329-32.

36. B. BALASSA & M. NOLAND, JAPAN IN THE WORLD ECONOMY 177-89 (1988); E. LINCOLN, JAPAN—FACING ECONOMIC MATURITY 267-90 (1988); STAFF OF JOINT ECONOMIC COMMITTEE, 100TH CONG., 2D SESS., RESTORING INTERNATIONAL BALANCE: JAPAN'S TRADE AND INVESTMENT PATTERNS, 37-56 (Comm. Print 1988).

37. *E.g.*, I. MAGAZINER & R. REICH, MINDING AMERICA'S BUSINESS—THE DECLINE AND RISE OF THE AMERICAN ECONOMY (1982); E. VOGEL, COMEBACK—BUILDING THE RESURGENCE OF AMERICAN BUSINESS (1985).

38. D. FRIEDMAN, THE MISUNDERSTOOD MIRACLE: INDUSTRIAL DEVELOPMENT AND POLITICAL CHANGE IN JAPAN (1988).

this connection are every bit as important as its broader policy perspectives. It is important because it demonstrates the impact of our trade law structure in the context of the U.S.-Japan relationship. Peter Ehrenhaft has often complained that "we really don't know what the effect of our trade laws is, and we have been afraid to find out."<sup>39</sup> The several recent studies looking at the impact of our trade laws in the context of a particular bilateral relationship do indeed reveal that their effect has often not been that intended.<sup>40</sup> Prestowitz addresses the issue in the U.S.-Japan context with respect to both particular trade law remedies and broader structural and procedural issues. The crux of his argument is that the problems are structural and therefore require structural solutions,<sup>41</sup> and his analysis of particular trade law remedies demonstrates some of their inadequacies in the U.S.-Japan context.

In the area of dumping, Prestowitz observes in the semiconductor case that "Japan's industrial structure and competitive dynamics made dumping inevitable,"<sup>42</sup> and, more generally, that "[t]he combination of Japan's industry promotion policies and the peculiar nature of its companies . . . tends ultimately to create the problem of excess production capacity, which in turn leads to what the Japanese call 'excessive competition' involving severe price cutting."<sup>43</sup> Even if a Japanese manufacturer loses a dumping case brought against it, as a business decision the strategy to dump for purposes of gaining market share might make sense.<sup>44</sup> U.S. antidumping laws also impose heavy burdens on the private domestic companies which are usually the petitioners by imposing on them the burden of proving both that dumping is taking place and

39. *Symposium—American Trade Policy: Actors, Issues, Options*, YALE L. & POL'Y REV. 15 (Special Issue, No. 1, 1988) [hereinafter *Symposium*].

40. See A. RUGMAN & A. ANDERSON, *ADMINISTERED PROTECTION IN AMERICA* (1987) (U.S.-Canada); J. WHEELER & P. WOOD, *BEYOND RECRIMINATION: PERSPECTIVES ON U.S.-TAIWAN TRADE TENSIONS* (1987); D. YOFFIE, *POWER AND PROTECTIONISM: STRATEGIES OF THE NEWLY INDUSTRIALIZING COUNTRIES* (1983).

41. Witness his analysis of the hurdles U.S. semiconductor manufacturers confront in trying to increase sales to a significant share of the Japanese market:

The problem was much more subtle than tariffs and other formal trade barriers, which had largely been removed. It arose from several factors: the tight ties between Japan's manufacturers and their suppliers and distributors, which entail social obligations that go far beyond contractual dealings; the interlocking relations between major companies which enable them to ignore Western-style financial discipline; and the fact that, having long been encouraged by its government to displace foreign products, Japanese industry now did so as a kind of reflex action. In a word, the problem was structural. The whole industry was structured so as to reject, more or less automatically, penetration by outsiders or newcomers. Clearly, standard measures such as lower tariffs and simpler import procedures would not change this situation.

PRESTOWITZ, *supra* note 1, at 50-51.

42. *Id.* at 58.

43. *Id.* at 140; see also *id.* at 180-81.

44. *Id.* at 238-39.

that it has caused severe injury.<sup>45</sup> Actual calculation of dumping margins is complex and dependent on interpreting data supplied by the defendants.<sup>46</sup> Japanese companies responding to dumping complaints "can always count on assistance from Japanese government officials," while our own "government does not advise its companies in such circumstances."<sup>47</sup> Essentially, Prestowitz characterizes antidumping law as being effective only to the extent its invocation can provide leverage for negotiating broader agreements getting at some of the underlying structural inequities.<sup>48</sup>

With respect to countervailing duty law, Prestowitz suggests that "the American focus on specific subsidy amounts and specific government intervention causes misperception."<sup>49</sup> Moreover, the manner prescribed for calculating countervailing duties overlooks the fact that "a quite small subsidy can have a powerful effect."<sup>50</sup>

Prestowitz does not limit his criticism to statutes aimed at specific unfair subsidies and predatory pricing activities. He also takes aim at Section 301, a law which "theoretically gives a president power to do almost anything he wants in response to acts of a foreign government that are 'unreasonable, unwarranted, or unjustified,' and that thereby burden U.S. commerce."<sup>51</sup> Although such legislation would appear to be a powerful club, Prestowitz points out several reasons for which presidents are reluctant to use it.<sup>52</sup> He points out similar constraints on the application of Section 232, which enables a president to extend protection to critical industries if their ability to supply national defense needs

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The concepts of injury do not include recognition of the experience curve or of the fact that a company may be injured by a loss of market share even if it is growing in absolute terms. Thus, only actual financial losses, closure of factories, and layoffs of workers count as injury. . . . The procedure is costly and time consuming, and the penalty is not retroactive to the time dumping first occurred, but only to when it is first officially investigated. The result is that dumping is not inhibited.

*Id.* at 237-38.

46. *Id.* at 204-05.

47. *Id.* at 261.

48. *Id.* at 61. For some of the same reasons, as well as on grounds of economic efficiency, some knowledgeable commentators have been sympathetic to the notion of abandoning our administrative method of assessing antidumping duties and substituting for it a private damage action. Ehrenhaft, in *Symposium, supra* note 39, at 17; Horlick, *id.* at 45.

49. C. PRESTOWITZ, *supra* note 1, at 131.

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[T]he remedy is to calculate the amount of subsidy, divide that by the number of units produced to arrive at a subsidy per unit, and apply a countervailing duty of that amount to offset the advantage the subsidy gives the foreign product when the product is imported. Such a calculation often produces a ridiculous figure that has no meaning.

*Id.* at 237. Others have criticized countervailing duty law on somewhat different grounds. *E.g.*, Tarullo, *Beyond Normalcy in the Regulation of International Trade*, 100 HARV. L. REV. 547, 552-79 (1987).

51. C. PRESTOWITZ, *supra* note 1, at 239.

52. *Id.* at 239.

is likely to be impaired by imports.<sup>53</sup>

As important as these limitations on the application of specific U.S. trade law remedies may be, they are subordinate to the fundamental concern Prestowitz has with structural issues. He does not criticize the United States for having adopted a legalistic, judicialized approach to regulating imports "to a degree unmatched by other nations."<sup>54</sup> He does not criticize the United States for training lawyers while Japan trains engineers; indeed, he emphasizes the fact that the MITI officials who worked to enact the Extraordinary Measures Law for Promotion of the Electronics Industry "were trained in law, not engineering; and their tools were pens rather than micrometers."<sup>55</sup>

Rather, he focuses on the impact which the fundamentally different economic doctrines embraced by the U.S. and Japan have had on the two countries' law and policy. He sees American law and policy as rooted in Western economic doctrine of Adam Smith and David Ricardo, which "understands greater consumption to be the purpose of economic activity" and "holds that what nations produce is based on their resource endowment."<sup>56</sup> Modern Japan, on the other hand, adopted an alternate view of capitalist economic dynamics advanced by the Austrian economist, Joseph Schumpeter, in which "what matters is not price competition or resource endowment but the competition arising from new technology, new sources of supply, and new types of organization."<sup>57</sup> Thus, to the United States, "all industries have roughly the same economic and strategic value," while to the Japanese, "some industries are more important than others."<sup>58</sup>

It would be unrealistic to expect either Japan or the United States to abruptly change course, inasmuch as economic doctrine cannot be divorced from cultural proclivities. It may be that both countries' courses of action will have to be modified and tempered to accommodate the limitations our physical environment may increasingly impose on any type of growth-oriented economic doctrine. In any event, incremental change appears to be occurring. As one knowledgeable commentator recently observed,

I think that the United States government is finally starting to focus on the question of what policies make sense, not only for the producing

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53. *Id.* at 242-46.

54. Koh, in *Symposium*, *supra* note 39, at 7.

55. C. PRESTOWITZ, *supra* note 1, at 33. As Glen Fukushima of the U.S. Trade Representative's Office has noted,

despite the common wisdom that Japan is a "nonlitigious" society compared to the United States, law is important in Japan. Indeed, many Japanese government bureaucrats and business leaders have been trained in law, think like lawyers, and base their decisions on laws, ordinances, and regulations. Thus a knowledge of the application—as opposed to the theory—of Japanese law is essential to understand the parameters of economic activity.

Fukushima, Book Review, 47 J. ASIAN STUD. 898 (1988).

56. C. PRESTOWITZ, *supra* note 1, at 127.

57. *Id.* at 127-28.

58. *Id.*

industries, but for the consuming interest, and for the world trading system as a whole. It may be, however, that the only way that you can create a sensible trading system is to deny access to our market now and again as a tool for getting other governments to recognize that certain policies of theirs may not be in the overall world economic interest.<sup>59</sup>

There are risks in going too far in adopting any such course of action. The better we understand the context in which the response to such action will be formulated, however, the wiser our approach should be. *Trading Places* makes a significant contribution to enriching our knowledge for purposes of avoiding miscalculation.

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59. Stein, in *Symposium*, *supra* note 39, at 42.